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April 26, 2021

**VIA eFILING**

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

**Re: Pennsylvania Public Utility Commission v.
PECO Energy Company – Gas Division
Docket No. R-2020-3018929**

Dear Secretary Chiavetta:

Enclosed for filing in the above-referenced matter are the **Exceptions of PECO Energy Company to the Recommended Decision of Deputy Chief Administrative Law Judge Christopher P. Pell** ("Exceptions").

As evidenced by the Certificate of Service, copies of the Exceptions are being served upon Deputy Chief Administrative Law Judge Christopher P. Pell, all parties of record, and the Office of Special Assistants, as instructed in the Secretarial Letter dated April 12, 2021.

If you have any questions, please do not hesitate to contact me directly at 215.963.5384.

Very truly yours,

Kenneth M. Kulak

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Enclosures

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**BEFORE THE**
**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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| **PENNSYLVANIA PUBLIC UTILITY COMMISSION** | : | |
| | : | |
| **v.** | : | **Docket No. R-2020-3018929** |
| | : | |
| **PECO ENERGY COMPANY – GAS DIVISION** | : | |

**CERTIFICATE OF SERVICE**

I hereby certify and affirm that I have this day served a copy of the **Exceptions of PECO Energy Company to the Recommended Decision of Deputy Chief Administrative Law Judge Christopher P. Pell** on the following persons in the manner specified in accordance with the requirements of 52 Pa. Code § 1.54:

**VIA ELECTRONIC MAIL**

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Dated: April 26, 2021

*Counsel for PECO Energy Company*

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**BEFORE THE**
**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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| **PENNSYLVANIA PUBLIC UTILITY COMMISSION** | : | |
| **v.** | : | **Docket No. R-2020-3018929** |
| **PECO ENERGY COMPANY – GAS DIVISION** | : | |

# EXCEPTIONS OF PECO ENERGY COMPANY

## To The Recommended Decision Of Deputy Chief Administrative Law Judge Christopher P. Pell


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Dated: April 26, 2021


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# I. INTRODUCTION

On September 30, 2020, PECO Energy Company ("PECO" or the "Company") initiated this proceeding by filing Tariff Gas – Pa. P.U.C. No. 4 ("Tariff No. 4") with the Pennsylvania Public Utility Commission (the "Commission") to increase PECO's annual gas distribution rates by approximately $68.7 million, or 8.9%, on the basis of total Pennsylvania jurisdictional gas operating revenue.

PECO provides natural gas service to approximately 534,000 retail customers and gas transportation service to 1,800 large commercial and industrial customers through a 1,900 square-mile area in southeastern Pennsylvania adjacent to, but exclusive of, the City of Philadelphia. PECO's proposed rate increase in this proceeding is the first proposed increase for its gas distribution customers in over ten years.

PECO originally planned to file its proposed rate increase in March 2020, but voluntarily deferred its filing for six months in light of the COVID-19 emergency in the communities PECO serves. As a result of that decision, PECO ensured that its customers did not pay any increase in rates in 2020 during the COVID-19 pandemic and throughout the 2020-2021 winter heating season (when bills for gas service are substantially higher for many customers). However, the benefits to customers realized from PECO's deferral came at a cost to the Company of tens of millions of dollars in foregone revenue. At the same time, PECO undertook a variety of initiatives to help customers during the COVID-19 emergency in addition to implementing the Commission's moratorium on termination of service, which included waiving fees and deposits for reconnection of service, repurposing customer program funds for direct relief that could not be used safely for their original purposes during the pandemic, and introducing payment plans of up to 24 months for all residential customers.

By Order entered on October 29, 2020, the Commission instituted an investigation of PECO's existing and proposed gas distribution rates and the Company's proposed tariff was suspended by operation of law until June 29, 2021. This matter was subsequently assigned to Deputy Chief Administrative Law Judge Christopher P. Pell (the "ALJ") for hearing and the issuance of a Recommended Decision.[1]

On April 12, 2021, the ALJ issued his Recommended Decision ("RD"), proposing that the Commission approve additional annual operating revenues totaling only $23,892,717, or just 36% of the rate relief sought by the Company. To his credit, the ALJ rejected the "no increase" proposals of the Office of Consumer Advocate ("OCA") and the Coalition for Affordable Utility Services and Energy Efficiency in Pennsylvania ("CAUSE-PA"), accepted the Company's cost of service study ("COSS"), and recommended approval of a rate of return on common equity of 10.24%. The ALJ also properly concluded that a variety of OCA and CAUSE-PA proposals for new programs for low-income customers were either unnecessary or should be considered in the Company's pending 2019-2024 Universal Service Energy and Conservation Plan proceedings.

At the same time, however, the Company believes the Recommended Decision's proposed resolution of several critical issues is contrary to law and the substantial record evidence supporting PECO's claims. The principal flaws in the RD include:

- Reducing the Company's projected plant-in-service balances for the fully projected future test year ("FPFTY") ending June 30, 2022 by $47,624,803 based on a calculation by the Bureau of Investigation & Enforcement ("I&E") that erroneously assumed PECO claimed $38.5 million more for its Natural Gas Reliability Project

[1] A detailed history of this proceeding is set forth in the Company's Main Brief dated March 3, 2021 ("PECO MB"). PECO also filed a Reply Brief ("PECO RB") on March 15, 2021, and the Commission is urged to review both briefs in its consideration of these Exceptions. During the proceeding, as a result of various adjustments, PECO lowered its proposed rate increase to $66.2 million, a reduction of approximately $2.5 million. PECO MB, pp. 1-2.

than the Company actually included in its FPFTY plant additions for that project and ignored clear and unrefuted record evidence that the portions of the project PECO actually included in its FPFTY claim would be in service by June 1, 2022 (before the end of the FPFTY);

- Excluding rate recognition of the Company's $35 million pension asset based on an incorrect conclusion that investor-supplied capital is not used to meet the Company's pension contribution;
- Rejecting PECO's proposed FPFTY 639-employee complement and adopting a $2.9 million expense adjustment that would allow the Company to recover wages and salaries for only the 604 full-time employees on its payroll as of September 30, 2020 despite undisputed evidence that: (1) PECO's actual headcount at December 31, 2020 had reached 612 employees; (2) filling all 639 positions during 2020, as PECO planned, had to be extended into 2021 due to the pandemic-related postponement of its September 2020 Gas Mechanics School; and (3) the Gas Mechanics School has now been rescheduled for September 2021, which will provide ample opportunity for PECO to fill all of its claimed 639 positions within the FPFTY;
- Lowering the Company's FPFTY Contracting and Materials expense by $10.1 million by using a three-year average that does not adjust for the effects of the COVID-19 pandemic nor reflect the Company's subsequent actions to ensure that all scheduled construction projects will be completed;
- Relying upon incorrect calculations by I&E to reduce the Company's Outside Services FPFTY expense by $3.1 million; and

- Rejecting a proposed 25-basis point increase in the allowed return on equity in light of the Company's superior management performance.

These errors, and other errors addressed in these Exceptions, result in a recommended rate increase that will not be sufficient to provide a reasonable return on investment and support PECO's projected $1.2 billion in gas utility plant investment between July 1, 2020 and June 30, 2024.[2]

The Company firmly believes that all of the claims underlying its proposed revenue requirement are reasonable and fully supported by substantial record evidence. Nonetheless, in the interest of reducing the contested issues in order to focus on the portions of the RD that must be reversed in order to assure PECO has a reasonable opportunity earn a fair return, the Company has elected not to take exception to several other adjustments recommended by the ALJ, including rejection of the Company's proposals for expanded energy efficiency programs for customers, a revised amortization period for expenses associated with its manufactured gas plant remediation program, and certain employee programming. Therefore, if the Commission grants each of the Company's Exceptions, the resulting rates will provide PECO with an increase of $50.0 million, or 6.4% of its total Pennsylvania jurisdictional gas operating revenue.

## II. EXCEPTIONS

### A. Exception No. 1: The RD Improperly Reduced The Company's Claim For FPFTY Plant Additions (RD, pp. 19-25, 32-34, 39-42, 46-47)

The RD recommends adopting I&E's proposed adjustment to disallow $47,624,803 of the Company's claim for FPFTY plant additions despite the fact that I&E's own exhibit shows that $38.5 million of the proposed disallowance was not included in the Company's claim.[3] The

[2] *See* PECO MB, pp. 3-4.
[3] The RD also recommended an equally erroneous concomitant reduction of $804,000 to PECO's claim for annual depreciation expense.

origin of this erroneous adjustment was the mistaken assumption of I&E's witness that PECO had included $121,029,946 in its FPFTY plant additions for all three constituent components of PECO's Natural Gas Reliability Project. *See* I&E St. 3, p. 11. In reality, I&E's own supporting exhibit (I&E Exhibit No. 3, Schedule 2, p. 3) shows that PECO's claim for FPFTY plant additions includes only $82,481,428 for the Natural Gas Reliability Project ($38,548,518 less than the assumed starting point for I&E's proposed adjustment) because, as PECO's witnesses Ronald A. Bradley and Robert J. Stefani explained in detail, PECO only claimed two of the three constituents of the project as FPFTY additions in this case. PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.[4]

I&E's witness Ethan H. Cline tried to support his proposed adjustment by relying on I&E Exhibit 3, Schedule 2, page 3, which is a copy of the Company's response to an interrogatory that details all the projects in the Company's claim for FPFTY plant additions in this case. The sum of the original costs of all those projects is $322,146,422,[5] which is shown at the foot of the column titled "Additions to Capital per Schedule C-2 for the FPFTY." (Schedule C-2 of PECO Exhibit MJT-1 Revised sets forth the Company's FPFTY plant-in-service claim.) The first project listed under the subheading "Programmatic Total" is "Natural Gas Reliability." As previously explained, the total original cost claimed by PECO for that project is $82,481,428

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[4] The Natural Gas Reliability Project consists of three constituent components designed to meet demands for natural gas in the portion of the Company's distribution system located in Delaware County: (1) the installation of 11.5 miles of high pressure gas main; (2) the construction of a new gate station to reduce higher pressure gas to distribution-level pressures near the actual load center; and (3) upgrades to the Company's West Conshohocken liquified natural gas ("LNG") facility. Only the first two constituents of the total Natural Gas Reliability Project were claimed by PECO for inclusion in its FPFTY additions in this case because those components will be completed and providing service to customers during the FPFTY. The LNG facility upgrade will not be in-service during the FPFTY (its estimated in-service date is June 2023) and, therefore, PECO did not include that component of the Natural Gas Reliability Project in its claim for FPFTY additions. PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17.

[5] PECO reduced its gross FPFTY plant additions by $16,591,422 net of retirements. PECO's claim for FPFTY plant additions net of retirements is $305,555,000.

(which is shown on the applicable line in the column "Additions to Capital per Schedule C-2 for the FPFTY"). Consequently, the *only* amount included in PECO's FPFTY plant additions for the Natural Gas Reliability Project is $82,481,428. Indeed, if anything more than that figure had been included in PECO's FPFTY additions, the total would have been greater than $322,146,422, and it plainly is not. The figure of $322,146,422 carries over to PECO Exhibit MJT-1 Revised (showing the development of PECO's revenue requirement) and appears on Schedule C-2 (p. 16 of the exhibit), which lists the FPFTY plant additions included in the Company's rate base claim.

The simple arithmetic explained above conclusively establishes that PECO's FPFTY plant-in-service claim includes only $82,481,428 for the Natural Gas Reliability Project. Nonetheless, Mr. Cline ignored PECO's *actual* claim and, instead, conducted a convoluted computational exercise to try to interpolate what he hypothesized should be the cost of the total Natural Gas Reliability Project. In so doing, he backed into a figure of $121,029,946 by dividing PECO's capital expenditures as of the computation date for two of the three constituents of the Natural Gas Reliability Project ($33,888,358) by the completion percentage (28%) as of that date for the *entire* the Natural Gas Reliability Project (i.e., all three constituents, including the one not claimed in PECO's FPFTY additions).[6] Not surprisingly, because I&E's witness used entirely inconsistent data, his calculation produced a figure different from – and $38.5 million higher than – the original cost of the two constituents of the Natural Gas Reliability Project PECO *actually* claimed in its FPFTY plant additions.

[6] That the 28% competition percentage related to the entire project is evident from the fact that PECO's expenditures of $33,888,358 are 41% of the total original cost it actually claimed for the two constituents of the Natural Gas Reliability Project included in its FPFTY additions ($33,888,358/$82,481,428=.41).

Continuing his use of inconsistent data, Mr. Cline assumed that PECO "is projecting it will spend $87,141,561 over 2.5 years, or on a linear basis, $34,856,625 per year ($87,141,561/2.5 years)." However, the figure of $87,141,561 is wrong because it assumes PECO claimed $121,029,946 in its FPFTY additions for the Natural Gas Reliability Project when its actual claim is $82,481,428. The calculation also errs in using 2.5 years as the remaining future construction period because Mr. Cline mistakenly assumed that the in-service dates for the two constituent components of the Natural Gas Reliability Project claimed by PECO would be the same as the June 2023 estimated in-service date for the LNG upgrade component, which PECO did *not* claim because it would not be completed during the FPFTY. In fact, the 11.5-mile high-pressure pipeline and gate station will be completed and serving customers within the FPFTY, as Messrs. Bradley and Stefani testified. PECO St. 1-R, pp. 18-20; Hearing Tr. 213-17. Using those incorrect data and faulty assumptions, I&E's witness tried to linearly project PECO actual expenditures at the time of his calculation ($33,888,385) to show that the Company would complete only an additional $34,856,625 of the Natural Gas Reliability Project before the end of the FPFTY.

Based on his flawed calculation, Mr. Cline proposed an adjustment to disallow $47,624,803 of PECO's claim for the Natural Gas Reliability Project. However, I&E's proposed adjustment was calculated from a starting point of $121,029,946 ($38.5 million more than PECO's claim for the Natural Gas Reliability Project) and assumed a completion date (June 2023) that does not apply to the components of the project actually included in PECO's claim for FPFTY additions. As a result, I&E's proposed adjustment is unsupported and unjustified for the reasons explained in detail above.

Moreover, even using I&E's erroneous "linear" projection furnishes arithmetic proof that its adjustment is based on an incorrect starting point ($121,029,946 instead of PECO's actual claim of $82,481,428). PECO's actual expenditures on the claimed portions of the Natural Gas Reliability Project as of the date of I&E's calculation was $33,888,385. I&E's linear projection of PECO's actual expenditures estimates PECO will spend an additional $34,856,625 through the end of the FPFTY, for a total of $68,745,010 ($33,888,385 + $34,856,625). Even that incorrect figure would yield an adjustment to PECO's actual claim for the Natural Gas Reliability Project of only $13,736,415 ($82,481,428 - $68,745,010) not $47,624,803, as I&E proposes. However, no adjustment to the Company's FPFTY additions is warranted because PECO actually claimed only two constituents of the Natural Gas Reliability Project to be completed and in service during the FPFTY, just as PECO's witnesses testified and as supported by substantial record evidence.

### B. Exception No. 2: The Recommended Decision Errs In Rejecting Ratemaking Recognition Of PECO's Pension Asset (RD, pp. 26-29, 34-36, 42-46, 48-49).

PECO takes exception to the ALJ's recommendation to reject its request for rate recognition of a pension asset that the Commission has approved in three prior base rate cases for another electric utility during the 2010 to 2018 period. *See* PECO MB, pp. 22-25; PECO RB, pp. 13-16. The ALJ based his recommendation on arguments by I&E and the OCA that PECO's pension asset arises because of a "mismatch" between the ways pension costs are calculated for ratemaking purposes and under Generally Accepted Accounting Practices ("GAAP"), from which he incorrectly concluded that "there is no real infusion of capital or funds by the investors/stockholders that is eligible for return on investment." RD, p. 48. The Recommended Decision also tried to sidestep the anomaly of disallowing a pension asset for PECO that the Commission had approved for another utility by crediting I&E's and the OCA's contentions that

the Commission's prior approvals should be discounted because they were granted in the context of settlements (RD, p. 49). In so doing, the ALJ ignored the fact that the prior settlements themselves carved out the pension asset issue for consideration and approval as a separate term.[7] As explained hereafter, each of the Recommended Decision's purported bases for rejecting PECO's pension asset is factually and conceptually erroneous and, therefore, the ALJ's recommendation on this issue should not be accepted.

The pension asset arises from the different ways pension costs are calculated for ratemaking and financial reporting (GAAP) purposes. The Commission has generally required that, for ratemaking purposes, pensions costs be based upon a utility's cash contribution to its pension fund. For companies that are subject to GAAP's reporting requirements, pension costs must be determined for financial statement purposes on the basis of different rules, which are set forth in the Financial Accounting Standard Board Accounting Standards Codification Topic 715 ("ASC 715"), which was formerly Statement of Financial Accounting Standard 87 ("SFAS 87"). Using these two calculation methods (as the Company must) produces a difference, each year, between PECO's pension costs calculated for ratemaking purposes (based on pension plan contributions, representing actual cash expenditures) and the amount of pension costs reflected for financial reporting purposes (based on SFAS 87, representing accrual-based accounting entries on PECO's financial statements). PECO St. 3-R, p. 10.

Pension costs are a portion of total employee compensation. Therefore, just as it does with the salary and wage component of employee compensation, PECO calculates the amount of

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[7] *See Pa. P.U.C., v. Duquesne Light Co.*, Docket No. R-2010-2179522, Statement in Support of Settlement on Behalf of the Office of Consumer Advocate, p. 4 ("This [settlement] represents a 'black box settlement' with the limited exceptions of Other Post Employment Benefits (OPEBs) and pensions."). *See also id*. at 8, expressing the OCA's agreement that recognizing the pension asset "resolves the unfavorable differences in recording pension contributions for ratemaking purposes and recording pension contributions for financial reporting purposes."

total pension costs that reflects the proportion of employee time directly devoted to capital projects, which is represented by a capitalization rate.[8] The complement of the capitalization rate is the proportion of employee compensation costs (including pension costs) that are not capitalized and, therefore, are charged to annual operating and maintenance ("O&M") expense for ratemaking purposes.

As previously explained, consistent with Commission ratemaking policy, PECO calculates its total pension costs based on the cash contribution to its pension plan. The pension cost PECO recovers as an operating expense is what remains after it has deducted an amount calculated by applying the capitalization rate to the pension contribution. The portion of PECO's total pension contribution that it does not recover as an operating expense is assumed to be capitalized, to be included in the original cost of PECO's utility plant in service, and to be reflected in the rate base on which it is entitled to earn a return. However, PECO must include in its utility plant accounts an amount that is calculated under the different rules imposed by SFAS 87. Therefore, the amounts assumed for ratemaking purposes to be included in PECO's plant accounts (based on applying a capitalization rate to its cash pension contribution) necessarily differ from the amounts that actually capitalized under GAAP. PECO St. 3-R, p. 11. This effect was explained and quantified by PECO witness Michael J. Trzaska (PECO St. 3, p. 23):

> Using the FPFTY ending June 30, 2022 as an example, as shown on Schedule D-9, PECO's total pension cash contribution will be $13.0 million, of which 21.25% is attributable to gas distribution. PECO's capitalization rate is 41.62%. Therefore, $1.1 million ($[13.0 million x 21.25% x 41.62%]) was assumed to be capitalized and included in applicable plant accounts. However, in the FPFTY, as in each prior twelve-month period, the amount PECO included in applicable plant accounts for capitalized pension costs was calculated on the basis of ASC 715 [SFAS 87], as GAAP

[8] The capitalization rate is expressed as a percentage. For the FPFTY, PECO's capitalization rate is 41.62%. PECO St. 3, p. 23.

> and applicable financial reporting mandates require. For the FPFTY ending June 30, 2022, the amount of pension cost actually capitalized would be only $0.1 million. As a consequence, there was a gap of $1.0 million of pension costs. As shown on Schedule C-5, the pension asset balance at the end of the FPFTY will be $35.1 million for gas distribution operations.

To summarize, the pension asset reflects the difference between: (1) the amount of pension costs the Commission's ratemaking methodology assumes should be included in PECO's plant accounts; and (2) the amount of pension costs actually included in PECO's plant accounts. The net aggregate difference, as of the end of the FPFTY in this case, is a pension asset of $35.1 million (PECO Exhibit MJT-1, Schedule C-5).[9] The pension asset claimed by PECO, therefore, consists of $35.1 million of investor-supplied capital that was actually contributed to PECO's pension fund and was assumed for ratemaking purposes to be included in PECO's plant accounts even though it could not be so recorded because GAAP rules will not allow it. Unless PECO is permitted to earn a return on the pension asset,[10] it will never recover the carrying costs it is actually incurring on those cash-based, investor-supplied funds. PECO is only proposing to include the pension asset to recover the associated carrying costs on a prospective basis and is not seeking to recover any carrying cost that it bore in any prior years during which a pension asset existed. *Id.,* pp. 11-12.

The Recommended Decision, repeating a characterization advanced in the testimony of I&E's witness, attaches the label "mismatch" to the difference between the ratemaking and GAAP calculations of capitalized pension costs and, on that basis, assumes that the pension asset

[9] The net aggregate difference between the amounts assumed to be capitalized for ratemaking purposes and the amounts actually capitalized under GAAP results in a pension asset at this time. However, as explained *infra*, the relationship between the assumed and actual capitalized amounts can reverse, such that the net balance could become a pension *liability*. PECO has clearly stated that, under the latter scenario, the net pension liability would be deducted from the rate base on which it earns a return.

[10] PECO is not requesting depreciation or amortization of the principal amount of the pension asset and, therefore, it is not included in the rate base on which PECO's depreciation and amortization were calculated in this case.

does not represent a "real infusion of capital or funds by the investor/stockholders." RD, p. 48. The Recommended Decision's conclusion, however, does not follow from its premise. The "mismatch" certainly exists. However, as illustrated by the uncontested calculation Mr. Trzaska performed, the existence of the "mismatch" does not diminish the reality of the cash contributions PECO makes to its pension plan. To the contrary, the "mismatch" highlights the fact that the pension costs the ratemaking process assumes to be capitalized are not actually included in PECO's plant accounts.

The error in the ALJ's assumption that the pension asset does not represent a "real infusion of capital or funds" is even more apparent when one considers what would happen if the "mismatch" were eliminated. Specifically, if the portion of total pension costs that PECO capitalizes were *not* constrained by GAAP, PECO's actual practice would conform to the assumption underlying the Commission's current ratemaking approach. In that case, PECO would record in its plant accounts *all* of the pension costs that it does not charge to operating expenses for ratemaking purposes. And because the amount PECO would include in its plant accounts would consist of a portion of the actual *cash* contribution to its pension fund, there would be no question that the capitalized costs were "a real infusion of capital or funds."[11] Indeed, that is precisely the outcome where wages and salaries are concerned. Wages and salaries are also apportioned between capital and expense for ratemaking purposes, but the amount included in plant accounts is not constrained by differences in the way wages and salaries are calculated for ratemaking and financial reporting purposes. In short, by asking for recognition of a pension asset, PECO is only seeking to have the capitalized portion of pension

[11] Stated another way, the pension costs capitalized per GAAP plus the pension asset equal the amount of pension costs the Commission's ratemaking process assumes PECO should be able to include in its plant accounts (i.e., total pension contributions less the amount charged to operating expenses for ratemaking purposes).

costs treated exactly the same way the capitalized portion of wages and salaries are recognized in the ratemaking process.

Moreover, failing to recognize the difference between pension costs the ratemaking process assumes are capitalized and pension costs actually capitalized (under GAAP) would produce the result the ALJ was trying to avoid, namely, increasing plant accounts by an increment that is not "a real infusion of capital or funds." That outcome would occur whenever capitalized pension costs calculated under SFAS 87 exceed pension costs assumed to be capitalized for ratemaking purposes. In that scenario, the excess SFAS-87 capitalized pension costs would be included in plant accounts despite the fact that they are not backed by PECO's actual cash contributions to its pension fund and, therefore, using the ALJ's criterion, are not "a real infusion of capital or funds" by investors. However, using the correct approach, as PECO proposes, the net aggregate excess SFAS-87 pension costs would generate a pension liability, which would be deducted from rate base and, thereby, assure PECO does not earn a return on GAAP accounting entries that are not cash-based. The capitalized pension differential can, over time, swing between a net pension asset and a net pension liability. Recognizing the pension asset or liability in rate base, as PECO proposes, ensures that the Company earns a return only on its actual investment in plant in service (determined by cash expended for its pension contribution) – neither more nor less.[12] Thus, PECO's approach is fair to both the Company and customers.

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[12] Recognizing a pension asset or pension liability, as applicable, would eliminate the "mismatch" between the pension costs assumed to be capitalized for ratemaking purposes and pension costs actually capitalized under GAAP. The pension asset or liability, therefore, reconciles the rate base on which PECO earns a return to its actual investment in utility plant in service, which, under Commission ratemaking principles, is properly determined by reference to its cash pension fund contributions. The ALJ's recommendation, which rejects the recognition of both a pension asset and pension liability, always produces either a deficiency or an excess in the amount of pension costs capitalized to PECO's plant accounts. Thus, under the ALJ's recommendation, at any given point in time, either the Company or its customers would be disadvantaged.

The ALJ also declined to give any weight to the Commission's approvals for Duquesne Light Company ("Duquesne Light") of a pension asset like the one PECO proposes. The ALJ hypothesized that the Commission would simply ignore its own prior approvals because they were granted in settlements that, according to I&E, represented its "negotiated compromise" on contested issues and, according to the OCA, were "black boxes" subject to "conditions" – principally that the settlements were entered into "without prejudice" to positions the parties might take in future proceedings. RD, p. 49. The ALJ's reliance on I&E's and the OCA's contentions is misplaced because those contentions are contradicted by the facts in the prior Duquesne Light proceedings.

While I&E claims its willingness to agree to the settlement term accepting Duquesne Light's pension asset represented a "compromise" of contested issues, the facts tell a different story. In each of the relevant Duquesne Light base rate cases (2010, 2013 and 2018), I&E did not contest Duquesne Light's proposed pension asset.[13] Consequently, I&E cannot credibly characterize its agreement to Duquesne Light's pension asset as a "compromise" on its part. It also underscores the contradiction between I&E's acceptance of the pension asset in three prior Duquesne Light base rate cases and its opposition to PECO's proposed pension asset in this case.

The OCA also ignores highly relevant facts in contending that the Commission's prior approvals of Duquesne Light's pension asset are negated by the "black box" nature of those settlements and by settlement "conditions" allowing parties to subsequently argue contrary positions. Significantly, the OCA itself recognized that the separately-stated pension asset term of Duquesne Light's Joint Petitions for Settlement was an "exception" – a carve-out – from the

[13] *See e.g.*, *Pa. P.U.C. v. Duquesne Light Co.*, Docket No. R-2018-3000124 *et al.* (Opinion and Order entered Dec. 20, 2018); I&E St. 3, pp. 35-36 (identifying pension costs capitalized by Duquesne Light based on recognition of a pension asset as a claim that I&E was not opposing).

"black box" representing the agreed-upon revenue requirement. In *Pa. P.U.C., v. Duquesne Light Co.*, Docket No. R-2010-2179522, which was the very first case in which the pension asset was approved, the Statement in Support of Settlement on Behalf of the Office of Consumer Advocate ("2010 Statement in Support") provides, at page 4, that the Joint Petition "represents a 'black box settlement' with the limited exceptions of Other Post Employment Benefits ("OPEBs") and pensions." The OCA's statement mirrors the structure and format of the Joint Petition, which sets forth the pension asset as a separate term that stands apart from the "black box" portion of the settlement. Accordingly, Paragraph No. 36 of the Joint Petition for Settlement provides, in relevant part, as follows:

> 50% of actual pension contributions from January 1, 2007, forward, net of related accumulated deferred income taxes, [will be included] in rate base for rate making purposes. The rate base adjustment for pensions shall be the amount necessary to adjust the SFAS 87 capitalized pension amounts to equal accumulated capitalized pension contributions, net of applicable deferred income taxes, from January 1, 2007, forward. The depreciation expenses for book and ratemaking purposes will be based on the SFAS 87 capitalized amounts.[14]

Additionally, despite the OCA's attempt to minimize the weight and significance of the Duquesne Light settlements, its 2010 Statement in Support discussed each of the black box "exceptions" and expressly stated that the pension asset should be affirmed by the presiding Administrative Law Judges and the Commission because it "resolved" the "unfavorable" ratemaking treatment that Duquesne Light would otherwise experience:

> This provision will permit the Company to include the capitalized portion of it cash contributions to the pension in its rate base without affecting depreciation expenses. Allowing this change resolves the unfavorable differences in recording pension

[14] This term was approved in the Recommended Decision issued on January 28, 2011, which accepted and approved all the terms of the Settlement without modification (pp. 27, 42, 60-61). On February 24, 2011, the Commission entered a final Order that adopted the ALJs' Recommended Decision in total.

> contributions for ratemaking purposes and recording pension contributions for financial accounting purposes.[15]

In summary, the pension asset term of the Duquesne Light rate case settlements was not part of the "black box," was identified and discussed as a separate term of the settlements, and was specifically addressed in the OCA's 2010 Statement in Support, which acknowledged the merits of Duquesne Light's pension asset claim. Denying PECO's claim for recognition of its pension asset claim would create an irreconcilable conflict with the position the OCA had taken in three prior Duquesne Light rate cases and with the Commission's approval of Duquesne Light's pension asset in each of those cases – approvals that were based on the OCA's substantive support of Duquesne Light's claim and I&E's total non-opposition to the pension asset claim in those prior proceedings.

For all the foregoing reasons, PECO's exception should be granted, the ALJ's recommendation should not be adopted, and the Commission should approve PECO's pension asset in this case.

### C. Exception No. 3: The Recommended Decision Improperly Concludes That PECO's Forecasted Employee Complement For The FPFTY Is Speculative (RD, pp. 56-60, 99-101, 121-22)

PECO's claims in this case for payroll expense, employee benefits and payroll taxes are based upon 639 full-time equivalent ("FTE") employees that PECO plans to have on its payroll for the FPFTY. The 639-employee complement consists of the 602 FTE employees on the Company's payroll for the historic test year ("HTY") ended June 30, 2020, and 37 employees (the vast majority of whom will be hired for field work) that PECO will add by the end of the FPFTY to staff its gas operations. PECO St. 2-R, pp. 10-11.

[15] 2010 Statement in Support, pp. 7-8.

The OCA proposed adjustments to PECO's payroll expense, employee benefits and payroll taxes to reflect an employee complement of only 604 FTEs, which was PECO's actual headcount on September 30, 2020 – three months after the end of the HTY. The ALJ recommended accepting the OCA's proposed adjustment because, in his view, PECO would not reach its full forecasted 639-employee complement by June 30, 2022 "considering that the Company fell substantially short of its anticipated headcount for 2020." RD, p. 121.[16] That recommendation is contrary to the evidence and should be rejected.

First, PECO is actively engaged in the process to hire the remainder of the 37 employees it plans to have on its payroll in the FPFTY. In fact, by December 31, 2020, PECO's actual headcount had already reached 612 FTE employees. Significantly, gas operations personnel must complete PECO's structured training program, which begins with a six-week "Gas Mechanics School," before they progress to employee status. If the Gas Mechanics School had been conducted as planned, PECO's hiring from that pool of qualified candidates would have brought its complement of employees to 635 by year-end 2020. However, as the ALJ correctly noted, the COVID-19 emergency temporarily delayed PECO's hiring of its planned level of employees in 2020 largely because the Gas Mechanics School scheduled to begin in March 2020 had to be postponed due to the pandemic. *See* RD, pp. 57-58, 121. However, the ALJ appears not to have considered that the Gas Mechanics School has been rescheduled for September 2021 with a projected class size that will support at least 20 new hires. PECO St. 2-R, pp. 11-12.

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[16] The ALJ also accepted the OCA's proposed adjustment to disallow PECO's proposal to normalize a one-time cash payment made in connection with the ratification of its current union contracts that will expire in 2021. *See* RD, pp. 58, 101-02, 121-22. While the Company does not agree with this recommendation, PECO is not taking exception because it will only reduce the Company's overall operating expense claim by $40,000. *See* PECO St. 3, p. 35; PECO Ex. MJT-1 Revised, Sch. D-6.

Notably, the ALJ's assumption that PECO is incapable of hiring any additional employees during the eighteen-month period from September 30, 2020 through June 30, 2022, is contradicted by clear record evidence in this case, which the ALJ appears not to have considered. Specifically, PECO established that its *actual* staffing level as of December 31, 2020 was 612 FTE employees – eight more than the ALJ's recommendation. PECO St. 2-R, p. 11. In short, the rationale underlying the ALJ's recommendation, namely, that PECO's forecasted employee additions are "speculative at best" is refuted by actual 2020 year-end data. It is also refuted by undisputed evidence that the Gas Mechanics School – the principal source of PECO's hiring pool for gas operations personnel – will take place in September 2021 notwithstanding its hiatus in 2020. Hiring from that talent pool, which is consistent with PECO's historic hiring processes and procedures, will enable PECO to have 639 FTE employees on its payroll by June 30, 2022 and, in all likelihood, well before that date. As this Commission has held in the past, utilities are in the best position to properly assess their staffing needs and implement hiring processes to achieve the employee complement needed to achieve their hiring goals, and the Commission should not lightly second-guess utilities' reasonable plans to fill the complement of employees they determine necessary to furnish safe and reliable service. [17] The Commission should use the same approach here and affirm PECO's claims for payroll expense, employee benefits and payroll taxes based on a complement of 639 FTE employees.

Significantly, I&E did not challenge PECO's planned complement of employees for the FPFTY. However, I&E mistakenly believed that the 639 FTEs underlying PECO's claim represented employees that, while authorized for budgetary purposes, did not represent the

[17] *See*, *e.g.*, *Pa. P.U.C. v. PPL Elec. Utils. Corp.*, Docket No. R-2012-2290597 (Opinion and Order entered Dec. 28, 2012) ("We agree with the ALJ that PPL is most familiar with its needs in terms of staffing, and that PPL's historical payroll supports a finding that the Company's claim is reasonable.").

number of employees that would actually be on PECO's payroll in the FPFTY and the rate application period. Based on that erroneous belief, I&E proposed to adjust PECO's 639-employee complement to reflect an average "vacancy" rate, which it calculated as the average difference between PECO's budgeted and actual FTEs for the three-year period ended June 30, 2020. *See* RD, pp. 81-83. However, the assumption underlying I&E's proposed adjustment is incorrect. PECO's proposed complement of 639 FTEs is based on the number of employees (602) actually on its payroll (i.e., filled positions, not merely budgeted positions) plus its planned addition of 37 employees. Consequently, there is no valid reason to apply I&E's calculated vacancy rate (2.1%) to the total of 639 employees, which includes the 602 *actual* filled positions at the end of the HTY. While there might be a theoretical justification for applying I&E's vacancy rate to the 37 additional positions included in PECO's payroll claim, as a practical matter that calculation yields an adjustment to PECO's FPFTY headcount of less than one FTE and a corresponding reduction to its operating expense claim of only $46,200. PECO St. 2-R, pp. 10-11.

PECO recognizes that the Commission recently disallowed Columbia Gas of Pennsylvania Inc.'s ("Columbia's") claim for the addition of 59 new employee positions and, instead, granted an allowance for salary and wage expense (and related employee benefits and payroll taxes) based on the highest level of employees Columbia had actually experienced in the future test year ("FTY") in its case (calendar year 2020).[18] However, Columbia calculated its salary and wage claim much differently from the approach PECO has used, and the difference in calculation methods makes the Commission's employee-headcount decision in *Columbia Gas* totally inapplicable to PECO's claim in this case.

[18] *Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, Docket No. R-2020-3018835 (Opinion and Order entered Feb. 19, 2021) ("*Columbia Gas*"), pp. 71-72.

Columbia based its claim on the number of employee *positions* that had been *authorized* in its budget for its future and fully projected future test years, irrespective of whether those positions would be filled during the rate application period. In short, Columbia's salary and wage claim included expenses for positions that would be vacant (due to retirements, attrition and similar causes) during the rate application period, as Columbia readily acknowledged. *See* Columbia Reply Brief, pp. 22-23. Columbia contended that it did not matter, for purposes of calculating employee compensation, whether all of the positions authorized for inclusion in its budget were filled or not because, if they were unfilled, Columbia would, nonetheless, incur overtime and temporary employee expenses approximating the salaries and wages it would have paid if the unfilled positions were occupied. *Id*.

In stark contrast to Columbia's approach, PECO does not budget based on employee positions that are merely *authorized*. PECO began with employee compensation reflecting the employees that were *actually on its payroll* during the HTY. In other words, the starting point for PECO's employee headcount already reflected the effect of the vacancies that occurred during that historical period. To that figure, PECO added the compensation and related benefits and employment taxes for new positions to be added during the FTY ending June 30, 2021 and FPFTY (37 FTE positions).[19] *See* PECO St. 3, pp. 34-35; PECO Ex. MJT-1 Revised, Sch. D-6. As previously discussed, PECO explained fully its plan to fill those positions primarily from graduates that completed the course of training in the Gas Mechanics School that PECO uses as its principal hiring pool. And, unlike Columbia, PECO is *not* claiming a level of overtime or temporary/contract workers that would offset the reduction resulting from disallowing its new hires. Thus, in PECO's case, a reduction in salary and wage expense and associated benefits and

[19] As previously explained, applying a reasonable vacancy rate to the 37 new positions produces a reduction of less than one FTE employee.

taxes would deny PECO recovery of compensation it will actually pay for employees needed to maintain service and who will actually be on its payroll within the FPFTY and beyond.

### D. Exception No. 4: The RD Improperly Adjusts The Company's Proposed Contracting And Materials Expense (RD, pp. 60-61, 83-84, 102-04, 122)

The Company's FPFTY revenue requirement includes contracting and materials expense of $42,955,000. The RD recommends adopting I&E's proposed adjustment to disallow $10,015,000 of PECO's claim by limiting the Company's recovery to a historical three-year average of the Company's contracting and materials expense. RD, p. 122. Contrary to the RD's analysis, the Company's claim was fully supported by substantial record evidence that shows I&E's proposed adjustment vastly understates the contracting and materials expense PECO will incur during the FPFTY. Accordingly, I&E's adjustment should be rejected and PECO's claim should be approved.

The RD offered two purported reasons for adopting I&E's simple three-year average in lieu of the level PECO had budgeted based on a careful and detailed analysis of its actual operational demands for the FPFTY. First, the ALJ noted that the Company spent less than it budgeted for contracting and materials expense in 2017, 2018, and 2019. Second, the ALJ hypothesized that the lower level of contracting and materials expense PECO experienced due to pandemic-related work stoppages in 2020 would carry over to 2021, and the ALJ concluded that it would be "speculative" to assume that normal levels of spending would prevail in the FTY and FPFTY. RD, p. 122.

PECO's senior management explained in this proceeding that the Company employed a rigorous budgeting process to determine its FTY and FPFTY O&M expenditures (including contracting and materials expense) and has recovered from initial COVID-19 related construction delays that had affected its operations and maintenance projects for part of 2020.

*See* PECO St. 2, pp. 10-12; PECO St. 2-R, p. 2; Hearing Tr. 249-51. In fact, the record in this proceeding demonstrated that there is no valid basis to assume that the pandemic will have *any* impact on the Company's projects in the FTY and FPFTY for which contracting and materials expense is incurred, or that the Company will *not* have to spend its entire budgeted amount for those periods. To the contrary, all evidence indicates that there will be no COVID-19 related impacts on such projects in the FTY and FPFTY, and the Company will spend its entire budgeted amounts for those periods.

As Mr. Stefani explained, the Company originally intended to file this base rate case in March 2020 with an HTY ended December 31, 2019. However, the Company made the decision to delay its filing by six months due to the COVID-19 pandemic for the benefit of customers. Hearing Tr. 250-51. As a result of that delay, in July 2020, the Company took the budget that was already approved by senior management in January 2020 for a March 2020 filing and refreshed it with the most up-to-date information to accommodate the use of a fiscal year ending in June (i.e., an HTY ended June 30, 2020).

The Company's updated budget reflected the Company's most current information regarding customer load, capital expenses, O&M expenses, depreciation and amortization expense, and interest and tax expense. In addition, since the update occurred approximately four months into the COVID-19 emergency, the update reflected impacts resulting from the pandemic. The updated budget was finalized in August 2020. *See* PECO St. 2-R, pp. 2-3; Hearing Tr. 249-51. As noted by Mr. Stefani, the budget process utilized by the Company for this rate case was neither abbreviated nor independent of the Company's normal budget process, and the budget was fully reviewed and authorized by the Company's senior management. PECO St. 2-R, p. 3; Hearing Tr. 251.

The Company also provided detailed testimony regarding the specific projects driving the increases in FTY and FPFTY contracting and materials expense. As explained by Mr. Stefani, the increases over the HTY amount projected for the FTY and FPFTY are being driven principally by: (1) PECO's activities to enhance its mapping system to improve the Company's ability to locate and track gas distribution facilities and associated increased investment in its gas mapping project;[20] (2) additional contracting and materials expense related to PECO's planned activities to reduce its non-emergent leak backlog;[21] and (3) additional security expenses in the FTY for crews working in high-crime areas. Expenses related to these items are anticipated to result in the Company incurring approximately $8 million in incremental spend over prior years in both the FTY and the FPFTY. *See* PECO MB, pp. 31-32. *See also* PECO Ex. MJT-1 Revised, Sch. D-4; PECO St. 2-R, pp. 17-19; Hearing Tr. 252-53. The ALJ's recommendation did not address this evidence.

The Company also demonstrated that it has largely recovered from the COVID-19 pandemic-related delays it experienced early in the pandemic and, for all intents and purposes, the Company is "back to normal." As Mr. Bradley explained:

> PECO experienced some delays on some projects [i]n the early months of the pandemic. But delays don't stop us from working on our system, and we've developed procedures to ensure that our construction teams can work safely and efficiently despite the pandemic. As a result, we were able to use 99 percent of our planned construction budget in 2020. Those procedures will remain in place as necessary to ensure the safety of our employees and our contractors during this pandemic, but they are not delaying our construction program and I do not know of any basis for

[20] The Company's agreed to increase its mapping in a Commission-approved settlement in *Pa. P.U.C. v. PECO Energy Co.*, P.U.C. Docket No. C-2015-2479970, Opinion and Order, pp. 4-6 (Oct. 27, 2016).

[21] The Company's locate expense has grown significantly since 2010 due to an increase in PA One Call locate requests. The Company is required, pursuant to the Underground Utility Line Protection Law, to respond to One Call requests seeking information regarding the location and type of its underground lines and mark, stake, locate, or otherwise provide the position of its underground lines at work sites. *See* 73 P.S. § 177.

> believing that our scheduled work for the [FTY] and the [FPFTY] will be delayed.

Hearing Tr. 218.

While the Company underspent its contracting and materials expense budget in recent years, the 2018-19 underspending was *de minimis* (2.76%) and the larger budget variance in the HTY (24.46%) was due to COVID-19-related impacts in the early months of the pandemic, which are not expected to impact contracting and materials expenses in the future. As Mr. Stefani noted at the evidentiary hearing, PECO is already on track to meet its FTY contracting and materials expense budget, and the Company will meet both its FTY and FPFTY budgets for contracting and materials expenses. *See* Hearing Tr. 251-53.

Use of the three-year average I&E calculated is particularly improper because the average is skewed lower by temporary COVID-19-related effects that occurred in the early months of the pandemic, but were reversed thereafter. Adopting I&E's proposal would preclude the Company from recovering contracting and materials expenses that it will incur, as it must, because the work those expenses reflect is unquestionably for necessary functions, including enhanced gas mapping, leak reduction, and safety programs. The Commission should, therefore, reject I&E's recommendation and approve the Company's claim in its entirety.

### E. Exception No. 5: The RD Improperly Adjusts The Company's Proposed Outside Services (RD, pp. 62-64, 84-86, 104-06, 122-24)

The Company is seeking recovery of approximately $22,135,000 in outside services expenses in the FPFTY. The Company's HTY actual outside services expense was $21,648,000, and the Company's FTY claim is $21,093,000. The Company's FPFTY claim thus represents an approximately 4.9% increase over the FTY, but only an approximately 2.25% increase over the HTY. The Company's FPFTY claim is also lower than the Company's historical three-year

average for outside services expense. *See* PECO MB, p. 34. *See also* PECO Ex. RJS-2-R, pp. 16-17.

The RD recommends that the Commission adopt I&E's proposed adjustment to the Company's outside services expense, which would reduce the Company's claim by $3,134,144. I&E proposed to reject the Company's FPFTY claim and instead adjust the Company's HTY actual outside services expense for inflation based on the Consumer Price Index ("CPI") factors of 2.75% to determine the FTY allowance, and an additional 2.03% to determine the FPFTY allowance.

I&E contended, and the ALJ agreed, that PECO has been experiencing a declining trend in costs from Exelon's internal business services company (which provides services to all Exelon utilities) and other contracting service costs and the Company failed to support its proposed increase in outside services expense from the HTY to the FTY. I&E MB, pp. 29-31. *See* RD, pp. 122-23. However, the RD ignores Company testimony that I&E is utilizing incorrect numbers to determine its recommended adjustment and thus, is incorrectly deriving its conclusions based on the portion of outside service costs in FERC Account 923 only. The portions of outside service costs in other FERC accounts were not included in I&E analysis, and thus did not capture the full universe of outside service costs. Applying I&E's proposed methodology to the correct numbers would yield an even greater claim for outside services expense than the Company is seeking.

As explained in the Company's Main Brief, I&E witness D.C. Patel's conclusions were drawn solely from an analysis of allocations to Federal Energy Regulatory Commission ("FERC") accounts contained in PECO Exhibit MJT-1, Schedule D-4, when Mr. Patel should have utilized the GAAP-based projections set forth in PECO Exhibit RJS-1 and Attachment III-

A-22(a), which were included in the Company's initial filing. *See* PECO MB, p. 34. *See also* PECO Ex. RJS-2-R, pp. 16-17. As a result, Mr. Patel only recognizes the PECO contracting charges allocated to FERC Account 923 – in other words, Mr. Patel only included a portion of the Company's overall outside services expense in his analysis. *Id.* Applying Mr. Patel's CPI factors to the HTY data set forth in Attachment III-A-22(a) (i.e., a starting point of $21,640,000 instead of the $12,818,000 starting point utilized by Mr. Patel) yields a greater FPFTY amount than is being sought by the Company.

The RD fails to address the Company testimony correcting Mr. Patel's calculations. However, giving proper consideration to the Company's proposal as set forth in PECO Exhibit RJS-1 and Attachment III-A-22(a) shows that PECO's claim for an approximately 2.25% increase from the HTY to the FPFTY is reasonable. Moreover, as I&E concedes, the use of inflationary factors to determine a pro forma expense allowance is consistent with Commission policy.[22] Therefore, the Commission should reject I&E's proposed adjustment to the Company's outside services expense.

### F. Exception No. 6: The RD Improperly Adopts OCA's Proposal To Adjust The Company's Proposed OPEB Expense (RD, pp. 64-66, 86-88, 106-07, 124)

The Company claimed OPEB expense of $1,050,000 in the FPFTY. The RD recommends that the Commission adopt the OCA's recommendation to reject the Company's proposed FPFTY OPEB expense and, instead, normalize the Company's OPEB expense over a three-year period, resulting in a $486,000 reduction to the Company's claim. RD, p. 124. The RD's stated rationale for adopting the OCA's proposal is that normalizing the Company's OPEB expense over a three-year period "will reflect a more accurate and normalized level of OPEB

[22] *See*, *e.g.*, *Pa. P.U.C. v. Phila. Elec. Co.*, 60 P.U.R. 4th 101 (1984).

expenses," and since OPEB expenses can fluctuate from year to year, "the normalization adjustment recommended by the OCA is reasonable." RD, p. 124.

The Commission should reject the recommended adjustment to the Company's OPEB expense. As explained by Mr. Stefani, the increase in the Company's OPEB expense is a direct result of the expiration of a prior service credit, which arose due to a change in 2014 in a Company-sponsored medical plan for eligible retirees with a traditional premium cost-sharing arrangement. A summary of the application of the prior service credit, prepared by the Company's independent third-party actuary, Willis Towers Watson, was provided as PECO Exhibit RJS-3RJ (Confidential). The Company also provided accounting reports prepared by Willis Towers Watson showing the financial impact of the prior service credit on the Company's current OPEB expense. *See* PECO Ex. RJS-2RJ (Confidential); Hearing Tr. 231-33.

The service credit is currently being amortized over the average remaining service period of the active plan participants, but the service credit will expire and the Company will lose the benefit of the associated amortization at the end of the FTY. The loss of that amortization will cause the Company's OPEB expense to increase from the FTY to the FPFTY, and the increase in OPEB expense the Company is seeking to recover is directly attributable to the loss of that amortization. *See* PECO St. 2, pp. 7-8; PECO St. 2-R, pp. 25-28; Hearing Tr. 231-33; PECO Ex. RJS-1RJ (Confidential), p. 15; PECO Ex. RJS-2RJ (Confidential), p. 15; PECO Ex. RJS-3RJ (Confidential), p. 3.

The ALJ recognized that the expiration of the prior service credits and associated amortization will result in an increase to the Company's OPEB expense, stating that he was adopting the OCA's proposed normalization "in order to properly capture the Company's predicted rise in OPEB expense due to the expiration of the prior service credit in 2021." RD, p.

124. However, this rationale stands at odds with the purpose of normalization, which is to identify and remove non-annual events that would unfairly skew recovery.[23]

The loss of the prior service credits is a known event that will occur at the end of the FTY. Determining the Company's recoverable OPEB expense by averaging three years of OPEB expense, when two of those years will include the application of the prior service credits that will not be available after the end of the FTY, will certainly unfairly skew recovery downward. Therefore, the Commission should determine that the OCA's proposed normalization is unreasonable, reject the RD's proposed normalization, and approve the Company's proposed OPEB expense.

### G. Exception No. 7: The Recommended Decision Improperly Adjusts The Company's Proposed Injuries And Damages Expense (RD, pp. 72-73, 112-14, 128-29)

As described in the Company's Main Brief (p. 43), PECO's FPFTY claim for injuries and damages expense of $638,000 is derived from an independent third-party actuarial report obtained by the Company. The OCA proposed to normalize the Company's claim based on the Company's historical three-year average, which would result in a $464,000 downward adjustment. OCA MB, pp. 59-61. In making its proposal, the OCA cited *A Guide to Utility Ratemaking* for the proposition that expenses that may occur at regular intervals, but in irregular amounts, should be normalized so that expenses are fairly recovered on an annual basis.[24] OCA MB, p. 60. The OCA argued that normalization is necessary for injuries and damages in order to avoid an over-recovery, pointing to the Company's historical expense, which has fluctuated from $301,000 in 2018, to -$9,000 in 2019, to $231,000 in 2020. OCA MB, p. 60. PECO explained that the negative $9,000 amount for the twelve months ended June 30, 2019 was an aberration

[23] James H. Cawley and Norman J. Kennard, *A Guide to Utility Ratemaking* (2018), p. 85.
[24] *See id.,* p. 86.

and the result of an actuarial update to the workers compensation, bodily injury and property damage reserve for that period. PECO MB, pp. 43-44.

The Recommended Decision (p. 129) adopted OCA's normalization proposal. While conceding that the negative $9,000 expense appears to be an aberration that "will undoubtably have an impact on the average," the ALJ reasoned that the OCA normalization proposal was the "best approach to smooth out the effects of this expense."

The Commission should reject the proposed adjustment in the Recommended Decision as unreasonable and inconsistent with the purpose of normalization. As explained in the Company's Reply Brief (p. 31), the historical three-year average is unreasonable since it would reflect a clear aberration in 2019 – a negative $9,000 expense – which was the result of an actuarial update. Further, the purpose of normalization is to identify and remove non-annual events that would unfairly skew recovery.[25] The negative amount at issue for injuries and damages is precisely the type of aberration that normalization attempts to avoid being reflected in rates, as it would unreasonably skew the Company's three-year average downward. *See* PECO MB, pp. 43-44. *See also* PECO St. 2-R, p. 24.

### H. Exception No. 8: The Recommended Decision Improperly Ignores Record Evidence Of Planned Infrastructure Improvements In Adopting A Five-Year Amortization Period For Rate Case Expense (RD, pp. 76-78, 96-97, 116-17, 131)

As described in the Company's Main Brief (p. 47), PECO has claimed an allowance for rate case expense of $1.6 million and proposes to amortize this amount over a three-year period, resulting in a normalized claim of $520,000 per year. The three-year amortization period is based on the Company's expectation that it will need to file a base rate case in three years. This rate filing timeline is driven by PECO's planned investment of $1.2 billion in new and

[25] *Id.*, p. 85.

replacement gas plant between July 1, 2020 and June 30, 2024. The Company's total rate case expense was not challenged by any party in this proceeding.

The Recommended Decision (p. 131) adopts I&E's and the OCA's proposal that PECO's rate case expense be amortized over a five-year period based on the Company's historical rate case filing frequency. The ALJ reasoned that a five-year period was consistent with *Columbia Gas*, where the Commission determined that Columbia's normalization period should align with historical data rather than Columbia's "assertion" about when it would file its next rate case.[26]

The ALJ failed, however, to address PECO's unrefuted record evidence concerning its plan to make over $1 billion in capital investments over the next few years. In *Columbia Gas*, the Commission found that it was reasonable to rely on a historic pattern of rate cases (i.e., on average, every 20 months) to determine the appropriate period for normalization of rate case expense *because* the magnitude of Columbia's 2020 infrastructure improvement plan would not necessitate annual rate relief.[27] In this case, however, PECO has provided evidence of substantial planned investments, which, when combined with even marginal year-over-year increases in O&M expenses, would not reasonably permit the Company to delay a rate filing for five years (PECO RB, p. 47). The Commission has previously affirmed that it is appropriate to consider evidence regarding the need for rate relief, such as ongoing capital improvements, in determining the appropriate normalization period for rate case expense.[28] For these reasons, the

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[26] I&E and the OCA also claimed that additional Commission orders, not cited by the ALJ, supported the use of historical filing frequency to determine the appropriate normalization period. The Company addressed those decisions in its Reply Brief (p. 35).

[27] *Columbia Gas*, pp. 78-79.

[28] *See, e.g., Pa. P.U.C. v. UGI Utils., Inc. – Elec. Div.*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018), p. 60 ("We agree with UGI that the ALJs did not properly consider the Company's planned acceleration of its capital expenditures in determining the appropriate normalization period…The record evidence supports a finding that a long period between base rate proceedings is highly unlikely and that the Company's proposed use of a three-year normalization period for rate case expense is appropriate.").

Commission should reject the ALJ's recommendation and adopt the Company's proposed three-year normalization period for rate case expense.

### I. Exception No. 9: The Recommended Decision Improperly Concludes That The Residential Customer Charge Should Be Included In Any Scale Back Of Rates In This Proceeding (RD, pp. 285-86, 303-04, 318-19, 406, 408-09)

The Recommended Decision (p. 406) found that, should the Commission approve less than the full requested increase, then all usage rates should be scaled back proportionately based on the COSS ultimately approved by the Commission. The Recommended Decision (p. 409) also agreed with I&E and the OCA that the residential customer charge should be included in any scale back of rates in this proceeding.

As explained in the Company's Main Brief (p. 116), PECO's proposed customer charge is intended to reduce the significant disparity between the Company's current residential customer charge and the residential customer-classified costs identified in the COSS that should be recovered through the customer charge. Customer-classified costs are, by definition, costs that vary based on the number of customers, not gas usage. *See* PECO St. 7, pp. 12-14; PECO St. 6, p. 28; PECO Ex. JD-5. Traditional ratemaking methodology dictates that a utility should be permitted to recover fixed customer class-related costs through fixed customer charges.[29] As explained by PECO witness Joseph A. Bisti, "[a] utility should, to the extent practicable, avoid including customer-classified costs in variable distribution charges because to do so would make the recovery of customer-related costs a function of customers' gas usage, which they are not." PECO St. 7, pp. 13-14.

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[29] As the Commission recently noted in its decision in *Columbia Gas* (p. 42), "the continued use of traditional ratemaking methodologies during this pandemic is consistent with the setting of just and reasonable rates and the constitutional standards established in *Bluefield* and *Hope Natural Gas*, and the pandemic does not change the continued application of these standards ." Those traditional methodologies include the "polestar" cost of providing service. *Id.*, p. 51 (citing *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1019-21 (Pa. Cmwlth. 2006) ("*Lloyd*"))).

In the Recommended Decision (p. 409), the ALJ agreed with I&E that the Company's proposed customer charge *is supported* by the customer cost analysis, but also expressed concerns about gradualism. PECO believes the proposed customer charge is consistent with gradualism because it falls below the level of demonstrated residential class customer-related costs and would be within a reasonable range of the residential customer charges of other major Pennsylvania gas utilities. Scaling back the proposed residential customer charge as the ALJ recommends is unreasonable because it would move the charge further away from the indicated cost of service. PECO MB, pp. 115-18; PECO RB, pp. 74-77.[30]

### J. Exception No. 10: The Recommended Reduction To Depreciation Expense Should be Rejected Consistent with PECO's Exception No. 1 (RD, pp. 80, 98, 135)

The RD recommends a $804,000 concomitant adjustment to the Company's depreciation expense associated with the ALJ's recommended adjustment to the Company's proposed FPFTY plant in service. The Commission should reject the RD's proposed adjustment to depreciation expense for the reasons set forth in Exception No. 1.

### K. Exception No. 11: The Recommended Denial Of Recognition For PECO's Superior Management Performance Should be Rejected (RD, pp. 168-69, 172-74, 194-98, 216-17)

In this proceeding, the ALJ recommended adoption of a cost of common equity of 10.24% as determined by I&E (RD, p. 215). PECO's rate of return witness, Paul Moul, testified that the I&E recommendation "would be reasonable if it were adjusted for the Company's exemplary management performance."[31] The ALJ, however, recommended against any

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[30] The Company has not otherwise excepted to the ALJ's recommendations regarding revenue allocation. However, the Company does disagree with the ALJ's apparent conclusion regarding the "fairness" of some rate classes receiving rate increases while other rate classes receive rate decreases. RD, p. 406. In applying traditional cost of service principles in accordance with *Lloyd*, it may be appropriate to decrease rates for some classes while other classes receive rate increases, and the Commission should avoid adopting contrary precedent in this proceeding.
[31] PECO St. No. 5-R, p. 2.

adjustment (RD, p. 216).

Section 523 of the Public Utility Code requires the Commission to consider management effectiveness in setting rates:

> The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.[32]

In prior cases, the Commission has adjusted upward the cost of equity to reflect management effectiveness after consideration of a wide variety of factors, including voluntary programs, enhanced customer satisfaction, and initiatives related to workforce safety and training.[33] The Commission has also recognized management effectiveness through increases in cost of equity, even in economically challenging times such as the 2008 recession.[34]

In the RD (pp. 215-16), the ALJ noted the testimony of Mr. Bradley, PECO Vice President of Gas, regarding PECO's quality and reliability of service, commitment to energy efficiency, use of cost-effective new technologies, its vigilance in protecting the safety of its workers, and its strong promotion of community and economic development. The ALJ also acknowledged PECO's control of O&M expenses over a decade, which limited the compound

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[32] 66 Pa.C.S. § 523(a).

[33] *See*, *e.g.*, *Pa. P.U.C. v. UGI Utils., Inc. – Elec. Div.*, Docket No. R-2017-2640058 (Opinion and Order entered Oct. 25, 2018) ("*UGI Electric 2018*"), pp. 114.

[34] *See Pa. P.U.C. v. Aqua Pa., Inc.*, Docket No. R-00072711, 2008 Pa. PUC LEXIS 50 at *63 (Jul. 31, 2008) (granting exception and rejecting ALJ recommendation of no recognition of management performance, approving 22-basis point increase in cost of common equity during recession and noting that utility's "performance related to its water quality, customer service and low income program continues to be laudable").

annual growth rate of O&M expense to only 1.9% (or 1.3% if increases in gas mapping and locate expenses since 2010 were removed).

In rejecting a proposed management adder of 25 basis points in light of PECO's commendable performance, the ALJ stated that he was "particularly persuaded" by I&E's argument that awarding the Company "management effectiveness points" would "cost the customer money for the Company to provide the adequate, efficient safe and reasonable service that is required by the Public Utility Code and Commission regulations," and that any savings from effective O&M measures should simply flow through to customers and investors. RD, p. 216.

The Commission should reject the ALJ's recommendation. Although the ALJ stated that he was "persuaded" by I&E's argument, I&E's witness simply declared that PECO's performance was "adequate,"[35] and the ALJ similarly makes no findings regarding PECO's actual performance.[36] This approach effectively ignores Section 523 by assuming that all service is "adequate" and, therefore, undeserving of any additional recognition, when Section 523 explicitly requires *consideration* of the adequacy of service. Notably, the Commission has previously considered I&E's broad argument that no management performance recognition should be provided for the performance of a utility's statutory obligations and still awarded an increase in equity.[37]

In this case, the record was replete with evidence of PECO's superior performance, including specific initiatives to enhance safety and reliability (such as enhanced mapping systems) and a wide variety of web and mobile capabilities to enhance communications with

[35] *See* I&E St. No. 2, p. 47.
[36] RD, p. 406 (citing only the testimony of I&E's witness).
[37] *See UGI Electric 2018*, pp. 112 & 114-15.

customers and provide customers with additional options for self-service.[38] Mr. Bradley also described the Company's dedicated efforts to support economic development in the communities it serves, as well as PECO's strong commitment to protecting and preserving the environment.[39]

Furthermore, the ALJ appears to have given no consideration to the Company's actions in response to the COVID-19 pandemic, including its original decision to delay the filing of its proposed rate increase by six months and the customer initiatives detailed in the testimony of PECO witness Kelly Colarelli.[40] PECO's decision to delay its proposed rate increase (at a cost of tens of millions of dollars) was recognized by the parties.[41] PECO's COVID-19 initiatives included extensive assistance to customers, temporary modifications to the eligibility requirements for the Company's hardship fund, as well as other programs that remain pending before the Commission.[42] In light of this continued superior performance, the Commission should approve PECO's requested 25 basis point increase to the cost of equity recommended by the ALJ.

### L. Exception No. 12: The Commission Should Clarify The RD's Recommendation Related to PECO's Negotiated Gas Service ("NGS") (RD, pp. 296-98, 306-07, 342-44, 402, 414-16)

PECO offers negotiated gas service to customers under its Commission-approved Rate NGS. To be eligible for service under Rate NGS, a customer must: (1) either have a history of at least 18,000 Mcf of annual natural gas usage billed by the Company, or, if a new customer, establish that the facilities to be served are likely to consume at least 18,000 Mcf of annual natural gas usage; (2) document a viable, currently available competitive alternative to service

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[38] PECO St. 1, pp. 16-19 & 19-22.
[39] *Id.*, pp. 22-24.
[40] PECO RB, p. 50.
[41] PECO MB, pp. 11-12.
[42] *Petition of PECO Energy Company for Public Meeting August 6, 2020 Expedited Approval of Temporary Universal Service Measures To Address COVID-19 Related Economic Hardship And Provide Additional Opportunities For Electric Usage Reduction*, Docket No. P-2020-3020555.

under Rates GC, L, TS-F, or TS-I; and (3) execute an NGS agreement that comports with all provisions set forth in Rate NGS. *See* PECO Ex. JAB-2, pp. 76-77. The ALJ adopted an I&E recommendation to require "PECO [to] provide an update to the competitive alternative analysis for any customer that has not had their alternative fuel source verified for a period of 5 years or more at the point when PECO files a base rate case." RD, p. 416.

PECO opposes this recommendation for the reasons set forth in its Reply Brief. Customers are not required to have an alternative fuel source to be eligible for Rate NGS; a customer can also be eligible for Rate NGS as a result of a pipeline bypass or a relocation opportunity. Therefore, it would not be reasonable to require PECO to evaluate all Rate NGS customers based on a verification of alternative fuel sources. In addition, when PECO and its customers enter Rate NGS agreements they evaluate the potential benefits of a Rate NGS service agreement over a lengthy period, which may be decades in the case of a bypass alternative or relocation opportunity. PECO RB, pp. 82-83. Thus, imposition of a five-year review could potentially create instability for the Company's Rate NGS customers and make it less likely that customers would enter into competitive agreements with the Company. PECO St. 7-R, pp. 22-23.

In the event that the Commission nevertheless accepts the ALJ's recommendation, PECO requests that the Commission clarify that it is not accepting the other parties' recommendations related to Rate NGS. Although the ALJ stated that he agreed with I&E's requests, he did not include any other requests in his actual recommendation to the Commission. RD, p. 416.

## III. CONCLUSION

For the reasons set forth above, the Commission should grant the Company's Exceptions and adopt the Recommended Decision with the modifications described herein.

Respectfully submitted,

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